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Financial Markets

Irving Trust

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Economic Research & Planning Division

Friday June 13, 1980

Interest rates moved uncertainly this week as market participants continued to weigh the likelihood that the Federal Reserve might be in the process of lowering its acceptable range for the Federal funds rate. The cause of concern is obvious: All indications are that recession momentum is building, while the $500 million decline in the money stock (M1B) reported last Friday puts its level almost $8 billion below the lower target level for the end of June. Nevertheless--contrary to the opinion of many market participants--the Federal Reserve appears not to have budged from its presumed 9% lower limit on the acceptable range for the Federal funds rate.

During most of the statement week beginning June 5, funds traded comfortably above 9%. On Tuesday, however, they opened at 8 1/2% and shortly began to decline. The Fed responded by entering the market to do one-day reverse repurchase agreements (which drain reserves) at about 10:20 a.m.--an unusually early time. When the rate eased again around noon, the Fed offered a second round of reverse RPs. In these actions the Fed clearly focused, not on the level of the rate per se, but the direction of change, which pointed to a reserve excess.

On Wednesday, funds again opened at 8 1/2%, but, unlike Tuesday, there was no change in the rate in early trading. Hence the Fed, which probably was projecting a reserve need, sat on the sidelines to wait until the need showed through to the market. Some market participants, however, interpreted the Fed's willingness to let funds trade below 9% as evidence that the acceptable range for the funds rate had been lowered. Later on Wednesday morning, funds traded up to 9 1/4%, and the Fed came in to do customer RPs (which add reserves). The timing of the move strongly suggests that the sharp upward movement in the rate did two things for the Fed: (1) it confirmed their projected reserve need, and (2) it allowed them to add reserves when funds were trading comfortably above 9%. Thereafter, the rate eased off. The Fed may have miscalculated the size of the need, or, more likely, the market's psychological response carried the rate down. Late Wednesday afternoon, the Fed purchased a small amount of Treasury bills--probably to get a leg up on its projected reserve-adding operations for the statement week beginning Thursday.

Thursday was a repeat in some ways of the day before. Funds opened at 8 1/2%. The Fed, presumably wishing to get going with the week's reserve-adding operations, nevertheless refused to do so as long as funds continued to trade below 9%.

Buoyed by Thursday night's reduction of the discount rate from 12% to 11%, funds opened at 8% on Friday morning and soon traded up to 8 3/8%. The Fed demonstrated its dissatisfaction with the rate by moving unusually early and offering reverse RPs. As of noon, funds were trading in the upper part of the 8 1/2 to 9% range, and the Fed was once again on the sidelines.

On the basis of the events this week, it appears likely that--as suggested in this letter last week--the Fed will stick to its current Fed funds rate limits in order to see whether money growth will soon resume at a more acceptable rate. Before the end of the month, however, the Fed will probably tolerate a lower funds rate, perhaps as low as 8%.

William C. Melton

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Market Yields

	6/13/80 (Noon)	Week Ago	Year Ago
Prime Lending Rate at Irving Trust Company			
Short-term loans to substantial depositors with highest credit rating	12.00%	13.00%	11.75%
Effective since	6/13/80		
Discount Rate at Federal Reserve Bank	11.00	12.00	9.50
Federal Funds	8.50	10.50	10.25
Repurchase Agreements	8.00	10.25	9.80
U.S. Treasury Issues			
Bills			
3 months	6.25	7.50	9.40
6 months	6.90	7.98	9.65
1 year	7.40	8.29	9.60
Coupons			
2 years	8.20	8.85	9.09
4 years	8.55	9.30	8.81
7 years	8.75	9.70	8.88
10 years	9.40	9.88	8.88
Long Bond	9.48	10.00	8.88
Negotiable Certificates of Deposit-Secondary Market			
1 month	8.25	8.80	10.00
3 months	8.25	8.75	9.95
6 months	8.10	8.45	9.93
1 year	8.00	8.50	9.85
Banker's Acceptances			
1 month	8.25	8.70	9.90
3 months	7.88	8.50	9.89
6 months	8.15	8.35	9.86
Eurodollar Deposits			
1 month	8.69	9.69	10.44
2 months	8.75	9.75	10.44
3 months	8.75	9.75	10.50
Commercial Paper - Prime Names			
Directly placed by:			
Finance Companies			
1 week	8.13	8.00	9.88
1 month	7.75	8.00	9.75
3 months	7.50	7.75	9.50
Bank Holding Companies			
1 month	7.50	8.63	9.88
Dealer Placed:			
3 months	7.75	8.50	9.65
New AA Corporate Utility Bond	11.00	11.65	9.75
Tax Exempt			
6 month Project Notes	3.70	4.60	4.60
1 year AAA Bond	4.60	5.10	N/A
5 year AAA Bond	5.10	5.30	N/A
20 year AAA Bond	6.50	6.60	5.70

This information represents prevailing market yields.
It should not be construed as an offering.
All yields are on the offered side of the market.

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